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No.

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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1995

PROMETHEUS FUNDING CORP., etc., et al.,
Petitioners,

VS.

MERCHANTS HOME DELIVERY SERVICES, INC.,
Respondent.

Petition For Writ of Certiorari
To The United States Court Of Appeals
For The Ninth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

The relevant provision of the McCarran-Ferguson Act [15 U.S.C. Section 1012(b)] provides that "No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any state for the purpose of regulating the business of insurance." Under this provision:

1. Does the assertion of claims under the Racketeer Influenced and Corrupt Organizations Act (RICO) based on activities which constitute the business of insurance "invalidate, impair, or supersede" comprehensive state laws enacted for the express purpose of regulating the business of insurance where RICO imposes treble damages and attorney fee awards but such damages and awards are unavailable under state law?

2. Does the phrase "enacted . . . for the purpose of regulating the business of insurance" apply narrowly so that a transfer of risk from the insured to an insurer is required or does it apply more broadly to encompass activities that are integral to the business of insurance and are made possible only because the business of insurance was at the heart of the transactional relationship between the parties?

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
PARTIES TO PROCEEDINGS AND DISCLOSURE STATEMENT	1
PETITION	1
I	
OPINIONS BELOW	2
II	
JURISDICTION	2
III	
STATUTORY PROVISIONS INVOLVED	3
IV	
STATEMENT OF CASE	4
V	
REASONS TO GRANT THE WRIT	7
A. Whether RICO Claims Can Be Asserted Against Entities Engaged In The Business Of Insurance Is An Issue Of Nationwide Importance Implicating Paramount Federal Statutory Policies On Which There Is A Conflict In The Cases	8
1. The Ninth Circuit's Opinion Finding That RICO Claims Are Not Preempted By McCarran-Ferguson Is In Apparent Conflict With Decisions By This Court And Exacerbates A Conflict In The State Appellate Courts And In The Federal District Courts On Whether RICO Claims Are Preempted	8

TABLE OF CONTENTS

Page

2. The Ninth Circuit's Opinion Misconstrues McCarran-Ferguson, Resulting In An Erroneous Expansion Of Federal Authority Over The Business Of Insurance 14

3. The Ninth Circuit's Opinion Will Disrupt The States' Regulation Of Insurance And Frustrate The Intent Of Congress 20

B. Whether The Phrase "Business Of Insurance" Should Be Narrowly Construed, Thereby Making Congress And The Federal Courts De Facto Regulators Of The Business Of Insurance, Is An Issue Of Nationwide Importance On Which There Is A Conflict In The Cases 22

1. The Ninth Circuit's Opinion Is In Apparent Conflict With This Court's Decision In *Fabe* Because It Narrowly Interprets The Phrase "Business Of Insurance" To Always Require A Transfer Of Risk 23

2. The Ninth Circuit's Opinion Will Create Confusion And Uncertainty In An Area Where Congress Has Mandated Certainty And Predictability Through State Regulation 25

VI

CONCLUSION 27

TABLE OF AUTHORITIES

Cases

Page

Adams v. Murakami, 284 Cal. Rptr. 318 (Cal. 1991) 16

Ambrose v. Blue Cross & Blue Shield of VA, Inc., ___ F. Supp. ___, 1995 WL 385165 (E.D. Va. June 27, 1995) 14, 17, 18

American Int'l Group, Inc. v. Superior Court, 285 Cal. Rptr. 765 (Ct. App. 1991), *review denied*, (Cal. Sup. Ct. Dec. 12, 1991), *cert. denied*, *Brutoco Engineering & Const. v. American Int'l Group, Inc.*, 504 U.S. 911 (1992) ..... *passim*

Brownell v. State Farm Mut. Ins. Co., 757 F. Supp. 526 (E.D. Pa. 1991) 15

California v. ARC America Corp., 490 U.S. 93 (1989) 18

Chemical Specialties Mfrs. Ass'n, Inc. v. Allenby, 958 F.2d 941 (9th Cir.), *cert. denied*, 113 S. Ct. 80 (1992) 18

Cochran v. Paco, Inc., 606 F.2d 460 (5th Cir. 1979) 9, 10

College Hosp., Inc. v. Superior Court, 34 Cal. Rptr. 2d 898 (Cal. 1994) 16

English v. General Elec. Co., 496 U.S. 72 (1990) .. 18

Everson v. Blue Cross & Blue Shield, No. 93CV7534, 1994 WL 675200 (N.D. Ohio 1994) 13

Federal Trade Comm'n v. National Cas. Co., 357 U.S. 560 (1958) 10, 20

Forsyth v. Humana, Inc., 827 F. Supp. 1498 (D. Nev. 1993) 13, 16

Garvey v. State Farm Fire & Cas. Co., 257 Cal. Rptr. 292 (Cal. 1989) 22

Gordon v. Ford Motor Credit Co., 868 F. Supp. 1191 (N.D. Cal. 1992) 13, 16

TABLE OF AUTHORITIES

Cases

Page

Group Life & Health Ins. Co. v. Royal Drug Co., 440 U.S. 205 (1979) 23

Leckey v. Aetna Cas. & Sur. Co., 590 A.2d 1255 (Pa. Super. Ct. 1991) 12

Mackey v. Lanier Collection Agency & Serv., Inc., 486 U.S. 825 (1988) 20

Manufacturers Life Ins. Co. v. Superior Court, 41 Cal. Rptr. 2d 220 (Cal. 1995) 15, 24

Moore v. Fidelity Fin. Serv., Inc., 884 F. Supp. 288 (N.D. Ill. 1995) 13

Moore v. Provident Life & Acc. Ins. Co., 786 F.2d 922 (9th Cir. 1986) 24

Moradi-Shalal v. Fireman's Fund Ins. Cos., 250 Cal. Rptr. 116 (Cal. 1988) 15, 16

Morales v. Trans World Airlines, Inc., 504 U.S. 374 (1992) 20

NAACP v. American Family Mutual Ins. Co., 978 F.2d 287 (7th Cir. 1992), *cert. denied*, 113 S. Ct. 2335 (1993) 6, 17, 18

Pilot Life Ins. Co. v. Dedeaux, 481 U.S. 41 (1987) 19

Prudential Ins. Co. v. Benjamin, 328 U.S. 408 (1946) 9, 19

Richhart v. Metropolitan Life Ins. Co., 1990 U.S. Dist. LEXIS 3597 (E.D. Pa. 1990) 13

Securities & Exch. Comm'n v. National Secs., Inc., 393 U.S. 453 (1969) 10, 18, 24

Senich v. Transamerica Premier Ins. Co., 766 F. Supp. 339 (W.D. Pa. 1990) 13, 21

TABLE OF AUTHORITIES

Cases

	Page
Shearson/American Express, Inc. v. McMahon, 482 U.S. 220 (1987)	11
Thacker v. New York Life Ins. Co., 796 F. Supp. 1338 (E.D. Cal. 1992)	13
Union Labor Life Ins. Co. v. Pireno, 458 U.S. 119 (1982)	23
United States Dep't of Treasury v. Fabe, 113 S. Ct. 2202 (1993)	*passim*
United States v. South-Eastern Underwriters Ass'n, 322 U.S. 533 (1944)	9
Western & S. Life Ins. Co. v. State Bd. of Equal., 451 U.S. 648 (1981)	18
Wexco Inc. v. IMC, Inc., 820 F. Supp. 194 (M.D. Pa. 1993)	13

Statutes

15 U.S.C. § 1011	3
15 U.S.C. § 1012(a)	3, 9
15 U.S.C. § 1012(b)	i, 3, 9, 23
15 U.S.C. § 1013	17
18 U.S.C. § 1961 *et seq.*	3
18 U.S.C. § 1964(c)	4, 17
28 U.S.C. § 1254(1)	3
28 U.S.C. § 1291	3
28 U.S.C. § 1331	3
Cal. Civ. Code § 3294	16
Cal. Ins. Code § 780	11
Cal. Ins. Code § 790 *et seq.*	4, 24

TABLE OF AUTHORITIES

Statutes

	Page
Cal. Ins. Code § 790	15
Cal. Ins. Code §§ 790.03 *et seq.*	16
Cal. Ins. Code §§ 790.03(b)	11

Texts

91 Cong. Rec. 481 (1945)	10
Black's Law Dictionary 1236, 1286 (6th ed. 1990)	24
Jonathan R. Macey & Geoffrey P. Miller, *The McCarran-Ferguson Act: Reconceiving The Federal Role Of Insurance Regulation*, 68 N.Y.U. L. Rev. 13, 30 (1993)	12
Webster's Third New International Dictionary 2295 (1986)	15

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PARTIES TO PROCEEDINGS AND DISCLOSURE STATEMENT

This petition is filed by Prometheus Funding Corp., which was formerly known as Frank B. Hall & Co. Inc. The petition is also filed by Frank B. Hall Insurance Brokers, Inc., a subsidiary of Prometheus Funding Corp. Frank B. Hall of California was a subsidiary of Frank B. Hall & Co. Inc. In 1990, Frank B. Hall of California was merged into Frank B. Hall Insurance Brokers, Inc. The operating assets of Frank B. Hall & Co. Inc. were sold to petitioner AON Corporation in November 1992. Other petitioners are Rollins Hudig Hall, and Rollins Hudig Hall of Southern Cali-

fornia, Inc., which are insurance broker subsidiaries of AON Corporation.

Petitioners also disclose the following related companies: Prometheus Funding Corp. is a wholly-owned subsidiary of Reliance Group Holdings, Inc.

PETITION

Petitioners respectfully pray that a writ of certiorari issue to review the judgment of the Court of Appeals for the Ninth Circuit, entered March 28, 1995. Petitioners' petition for rehearing and suggestion for rehearing en banc was denied by the Court of Appeals on June 8, 1995.

I

OPINIONS BELOW

The opinion of the Ninth Circuit (App. 14a-25a) is reported at 50 F.3d 1486 (9th Cir. 1995). The district court's order granting petitioners' motion for judgment on the pleadings is not officially reported and is reproduced in the Appendix at pages 1a-10a.

II

JURISDICTION

The Court of Appeals entered its judgment on March 28, 1995. The Court of Appeals denied petitioners' timely petition for rehearing and suggestion for rehearing en banc on June 8, 1995. (App. 11a-13a) The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1). The Court of Appeals' jurisdiction was based on 28 U.S.C. Section 1291, and the district court's jurisdiction was invoked under 28 U.S.C. Section 1331.

III

STATUTORY PROVISIONS INVOLVED

The relevant provisions of the McCarran-Ferguson Act state:

15 U.S.C. § 1011:

> Congress declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

15 U.S.C. § 1012:

> (a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.
>
> (b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: *Provided*, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

The relevant provision of the federal Racketeer Influenced and Corrupt Organization Act (18 U.S.C. § 1961 *et seq.*) (RICO) is section 1964, which is set forth in the Appendix at page 26a.

The California Unfair Insurance Practices Act (Cal. Ins. Code § 790 *et seq.*) is set forth in the Appendix at pages 27a-39a.

IV

STATEMENT OF CASE

In January 1986, Merchants Home Delivery Services, Inc. (Merchants) and two individuals, who were reportedly acting on behalf of Frank B. Hall & Co. of California, entered into an agreement for the provision of comprehensive insurance and related risk management services. (Appellant's Excerpts of Record [ER], filed with the Ninth Circuit Court of Appeals, at 14, 44-64) These individuals, acting as exclusive insurance brokers for Merchants, provided, or at least purported to provide, a complete package of insurance services, including negotiating and placing casualty insurance, supervising all underwriting and claims functions, managing and adjusting claims, and invoicing all premiums and "paid loss" billings from the insurers. (ER 14-15, 66) However, the two individuals involved allegedly were defrauding Merchants by overcharging for the insurance coverage obtained, charging for coverage that never was obtained, and overcharging for handling and resolving various self-insured claims. (ER 15-17, 20-24) Two employees of Frank B. Hall & Co. Inc. were later convicted of grand theft, in part because of activities related to the Merchants account.

After petitioners discovered the employees' activities, the employees were terminated and their activities were reported to Merchants. Merchants then sued petitioners in federal district court, seeking money damages based on several state law causes of action and alleging violations of the federal RICO statute. (ER 1-42) Based on the RICO allegations, Merchants sought an award of treble damages and attorney fees. (ER 40-42) See 18 U.S.C. § 1964(c).

The district court first declined to exercise jurisdiction over the state law claims and then dismissed the RICO claims on the ground that, under the McCarran-Ferguson Act, they could not be asserted against entities engaged in the business of insurance.[1] (App. 1a-10a) As the district court explained, McCarran-Ferguson barred application of RICO in this case because California has a comprehensive regulatory scheme for the business of insurance that expressly regulates all forms of insurance brokerage activities and prohibits fraud in connection with those activities. (App. 9a-10a) California law, however, does not permit awards of the treble damages and attorney fees that are mandatory under RICO. (App. 10a) In reaching this conclusion, the district court followed a California Court of Appeal decision that reached the same result for the same reasons. *American Int'l Group, Inc. v. Superior Court*, 285 Cal. Rptr. 765 (Ct. App. 1991), *review denied*, (Cal. Sup. Ct. Dec. 12, 1991), *cert. denied sub nom., Brutoco Engineering & Const. v. American Int'l Group, Inc.*, 504 U.S. 911 (1992). (App. 4a)

The Court of Appeals for the Ninth Circuit reversed. (App. 14a-25a) The Court first held that not all of the activities targeted by the RICO claims constituted the business of insurance. (App. 19a-22a) According to that Court, the business of insurance does not exist unless there has been a transfer of risk from the insured to an insurer accomplished by the issuance of an insurance policy. (App. 20a) Thus, of the allegedly fraudulent activities de-

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[1] While this litigation over the validity of the RICO claims was occurring, Merchants filed a parallel action in California state court. In that action, which petitioners asked the Ninth Circuit to judicially notice, Merchants alleged 23 causes of action against petitioners and other defendants and sought treble damages and attorney fees on various theories. However, the state trial court granted petitioners' motion to strike all claims for those remedies, thus confirming that the remedies available under RICO are not available to Merchants under California law.

scribed in the complaint, the Court found that only the overcharging for premiums on policies that actually existed was within the business of insurance. (App. 20a-21a) In contrast, the Court concluded that the business of insurance did not include charging for premiums for policies that did not exist or charging for fictitious claims for which Merchants was self-insured. (App. 21a-22a)

The Court of Appeals next held that, even as to the activities that were within the business of insurance, McCarran-Ferguson would not bar application of RICO. (App. 22a-25a) In so holding, the Court followed the reasoning of *NAACP v. American Family Mutual Ins. Co.*, 978 F.2d 287 (7th Cir. 1992), *cert. denied*, 113 S. Ct. 2335 (1993), which held that, under McCarran-Ferguson, there must be a direct conflict between federal and state law before that federal law would "invalidate, impair, or supersede" the state law. (App. 24a-25a) Based on this analytical model, the Ninth Circuit found that federal law did apply to activities within the business of insurance, even when those activities were extensively regulated by the states, so long as the remedies provided by federal law merely duplicated or were consistent with the remedies available under state law. (App. 25a) The Ninth Circuit thereafter reasoned that McCarran-Ferguson presented no bar to the RICO claims asserted by Merchants because the alleged fraud was prohibited by state as well as federal law. (App. 25a)

Petitioners sought rehearing and made a suggestion for rehearing en banc because: (1) the Ninth Circuit's holding that federal law had to conflict directly with state law before McCarran-Ferguson would apply could not be reconciled with this Court's decisions; (2) the Ninth Circuit's reasoning added to the confusion in this area of the law by disagreeing with the many state appellate court and federal district court decisions holding that McCarran-Ferguson does bar application of RICO to activities that are within

the business of insurance; and (3) the Ninth Circuit's holding that an activity could not be part of the business of insurance unless it effected a transfer of risk through an insurance policy also was at odds with this Court's interpretation of McCarran-Ferguson and will create uncertainty in this area of the law.

The Ninth Circuit denied petitioner's petition for rehearing and suggestion for rehearing en banc, although one judge voted in favor of rehearing en banc. (App. 11a-13a)

V

REASONS TO GRANT THE WRIT

In enacting McCarran-Ferguson five decades ago, Congress gave the states supremacy with respect to regulation of the business of insurance. In order to protect the states' ability to regulate the business of insurance, Congress provided that *unless* it expressly intended to have one of its laws apply to the business of insurance, that law could *not* be applied to "invalidate, impair, or supersede" a state law enacted for the purpose of regulating the business of insurance. The Ninth Circuit's opinion here, however, frustrates Congress' intent in two fundamental respects and, by doing so, invites the broad application of federal law to the business of insurance — the precise result Congress sought to forestall with the passage of McCarran-Ferguson.

First, the Ninth Circuit's opinion holds that federal laws such as RICO can always apply in tandem with state laws regulating the business of insurance so long as federal law does not actually conflict with state law. That holding cannot be reconciled with the reasoning in this Court's decisions, exacerbates an existing conflict in the case law, and is contrary to the relevant statutory language.

Second, the Ninth Circuit's opinion ascribes a narrow meaning to the phrase "business of insurance," so that many

activities normally associated with the business of insurance are deemed outside McCarran-Ferguson's scope and thus subject to regulation by federal law. That holding also conflicts with one of this Court's key decisions and will produce uncertainty in this area of law.

This Court therefore should grant certiorari to resolve these conflicts and provide needed guidance on the proper application of McCarran-Ferguson.

A. Whether RICO Claims Can Be Asserted Against Entities Engaged In The Business Of Insurance Is An Issue Of Nationwide Importance Implicating Paramount Federal Statutory Policies On Which There Is A Conflict In The Cases

1. The Ninth Circuit's Opinion Finding That RICO Claims Are Not Preempted By McCarran-Ferguson Is In Apparent Conflict With Decisions By This Court And Exacerbates A Conflict In The State Appellate Courts And In The Federal District Courts On Whether RICO Claims Are Preempted

The Ninth Circuit's opinion asserts that McCarran-Ferguson's bar against application of federal law to the business of insurance applies only where the federal law in question actually or directly conflicts with state law. But this Court has never said that such an actual or direct conflict is needed to come within McCarran-Ferguson and the Court of Appeals' opinion is in apparent conflict with this Court's important McCarran-Ferguson decisions. What is more, the opinion sharpens and exacerbates the conflict among courts nationwide on whether McCarran-Ferguson bars application of RICO to the business of insurance.

By way of background, Congress enacted the McCarran-Ferguson Act almost immediately after this Court held in

United States v. South-Eastern Underwriters Ass'n, 322 U.S. 533 (1944), that the business of insurance was within the reach of the Commerce Clause and thereby subject to regulation under federal law. Because that decision threatened to undermine the states' historical primacy over insurance, "Congress moved quickly to restore the supremacy of the states in the realm of insurance regulation." *United States Dep't of Treasury v. Fabe*, 113 S. Ct. 2202, 2207 (1993); *see also Prudential Ins. Co. v. Benjamin*, 328 U.S. 408, 429 (1946). Indeed, McCarran-Ferguson "transformed the legal landscape" where the regulation of the business of insurance is concerned by "overturning the normal rules of preemption." *Fabe*, 113 S. Ct. at 2211. In doing so, Congress (1) expressly declared that the states have primary jurisdiction to regulate the business of insurance [15 U.S.C. Section 1012(a)], and (2) expressly reversed the ordinary preemptive effect of federal law in favor of state law preemption of federal law where the state law is "enacted for the purpose of regulating the business of insurance" [15 U.S.C. Section 1012(b)].[2]

Senator Ferguson, one of the authors of the Act, explained its effect as follows:

> If there is on the books of the United States a legislative act which relates to interstate commerce, if the act does not specifically relate to insurance, it would not apply at the present time. Having passed the bill now

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[2]The lower federal courts have developed a four-part test for determining whether McCarran-Ferguson applies: (1) does the federal law in question specifically relate to the business of insurance; (2) do the activities at issue constitute the business of insurance; (3) has the state enacted laws for the purpose of regulating the business of insurance; and (4) if so, would the application of the federal law "invalidate, impair, or supersede" the state law. *Cochran v. Paco, Inc.*, 606 F.2d 460, 464 (5th Cir. 1979). As to at least some of the allegations involved here, there is no question that the first three parts of the test are satisfied.

> before the Senate, if Congress should tomorrow pass a law relating to interstate commerce, and should not specifically apply the law to the business of insurance, it would not be an implied repeal of this bill [the McCarran-Ferguson Act] . . .

Cochran v. Paco, Inc., 606 F.2d at 463 n. 7, quoting 91 Cong. Rec. 481 (1945); *see also Fabe,* 113 S. Ct. at 2211 n. 7 (quoting similar remarks).

This Court examined the "invalidate, impair, or supersede" prong of McCarran-Ferguson in *Securities & Exch. Comm'n v. National Secs., Inc.*, 393 U.S. 453 (1969) (*SEC*). There, the SEC sought to unwind a merger between two insurance companies that Arizona's Director of Insurance had approved because it did not harm the interests of policyholders. Although this Court held that McCarran-Ferguson was not a bar to that action, *SEC*'s rationale is at odds with the Ninth Circuit's reasoning and supports the opposite result here. In particular, this Court explained that Arizona's interest in protecting *policyholders* affected by the merger was much narrower than the SEC's important and broader interest in protecting the companies' *shareholders* (many of whom would not also be policyholders) who were harmed by a merger brought about through allegedly false representations. Thus, this Court held that this potential interference with a state law regulating insurance to be too "indirect" to be an obstacle to the pursuit of the "paramount federal interest" in regulating the securities markets. But at the same time, this Court cautioned that "[d]ifferent questions would, of course, arise if the Federal Government were attempting to regulate in the sphere reserved primarily to the States by the McCarran-Ferguson Act." *Id.* at 463.

The only other decision by this Court that touches on these issues is *Federal Trade Comm'n v. National Cas. Co.*, 357 U.S. 560, 563-64 (1958) (*FTC*), where this Court addressed whether the Federal Trade Commission could

regulate an insurance company's allegedly unfair and deceptive advertising practices carried out in states that had their own statutes regulating those practices. This Court held that the FTC could not, rejecting its claims that Congress had not intended to preclude application of federal law as a "supplement" to state action and that a state's "general regulation" of unfair practices should not supplant federal law. *Id.*

In contrast to these cases, the Ninth Circuit rejected application of McCarran-Ferguson even though Merchants is asserting RICO claims based on activities that are well within the "sphere" of the insurance regulatory concerns that McCarran-Ferguson commits "primarily to the States." California's comprehensive regulatory scheme applies here precisely because Merchants has alleged that fraud was committed in the course of the business of insurance, and there can be no question that California is committed to the prevention of fraud in such circumstances. *See, e.g.,* Cal. Ins. Code §§ 780 (prohibits brokers from making misrepresentations about terms and conditions of policy); 790.03(a) (prohibiting misrepresentations regarding terms and benefits of a policy); 790.03(b) (broad prohibition regarding misrepresentations in any public statement about the nature of a person's insurance business); 790.035 (authorizing civil penalties for committing any unfair practice).

Yet RICO applies, if at all, for exactly the same reasons — the alleged commission of fraud in circumstances where the insurance business activities involved are further claimed to constitute a RICO "enterprise." (ER 19-25) But in contrast to *SEC*, application of RICO in such circumstances does not further any "paramount federal interest." *See Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 240-42 (1987) (refusing to exempt civil RICO claims from Federal Arbitration Act in part because there is no overriding national interest in the deterrent aspects of a

"run-of-the-mill civil RICO" claim when asserted against a "legitimate" business). On the contrary, under the express mandate of McCarran-Ferguson the business of insurance is for the states to regulate without the intrusion of federal law.[3] *Fabe*, 113 S. Ct. at 2207. Moreover, application of RICO to the conduct alleged here does directly intrude into California's regulation of the business of insurance by providing mandatory remedies that are unavailable under California law. *American Int'l Group*, 285 Cal. Rptr. at 777; *see* discussion *infra* at pp. 14-17, 20-22.

The stark difference in approach to McCarran-Ferguson between *SEC* and the Ninth Circuit's opinion is amplified by appellate decisions from California and Pennsylvania. *American Int'l Group*, 285 Cal. Rptr. 765; *Leckey v. Aetna Cas. & Sur. Co.*, 590 A.2d 1255 (Pa. Super. Ct. 1991). Both cases hold that McCarran-Ferguson bars RICO claims because the assertion of even allegedly compatible federal law theories will "invalidate, impair, or supersede" state laws regulating the business of insurance. As the California Court of Appeal explained, permitting a RICO claim "for the very conduct which California has chosen to regulate administratively would subvert and subsume the existing

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[3] Commentators agree with this interpretation of McCarran-Ferguson and summarize the teaching of this Court's decisions as follows:

> [S]tate regulation of the business of insurance is considered to oust federal regulation when the state has adopted effective regulations specifically relating to the subject matter addressed by the federal regulatory scheme (whether or not the state law is as stringent as federal law). Federal regulation also is considered precluded when the state has regulated the business so comprehensively as to occupy the field of insurance regulation, even if the state does not have a specific regulation directed to the matter which the federal regulation is attempting to control.

Jonathan R. Macey & Geoffrey P. Miller, *The McCarran-Ferguson Act: Reconceiving The Federal Role Of Insurance Regulation*, 68 N.Y.U.L. Rev. 13, 30 (1993).

statutory scheme. It would permit a civil damage recovery where [the California] Supreme Court has recently and explicitly held that none was intended." *American Int'l Group*, 285 Cal. Rptr. at 777. The Ninth Circuit nevertheless ignored this California court's view of what the impact of RICO would be on California's regulation of the business of insurance.

Federal district court decisions reveal the same sharp conflict and also confirm that the question whether RICO claims may be aimed at the business of insurance is a frequently recurring issue at the forefront of McCarran-Ferguson jurisprudence. *Compare Wexco Inc. v. IMC, Inc.*, 820 F. Supp. 194 (M.D. Pa. 1993) (holding that McCarran-Ferguson precludes application of RICO), and *Gordon v. Ford Motor Credit Co.*, 868 F. Supp. 1191 (N.D. Cal. 1992) (same), *with Moore v. Fidelity Fin. Serv., Inc.*, 884 F. Supp. 288, 292-93 (N.D. Ill. 1995) (holding that RICO claims are possible despite McCarran-Ferguson); *Thacker v. New York Life Ins. Co.*, 796 F. Supp. 1338 (E.D. Cal. 1992) (same). To date a majority of district court decisions have held that RICO should *not* apply to the business of insurance.[4]

In light of this deep division in the cases, it is unlikely that other courts will uniformly follow the Ninth Circuit's opinion here, thus resolving the conflict without the need for this Court to intervene. In fact, the district court for the Eastern District of Virginia has already refused to follow the Ninth Circuit, explaining that the Ninth Circuit's reasoning is flawed and results in an unduly restrictive interpretation of

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[4] *E.g., Forsyth v. Humana, Inc.*, 827 F. Supp. 1498, 1520-22 (D. Nev. 1993); *Senich v. Transamerica Premier Ins. Co.*, 766 F. Supp. 339, 341-42 (W.D. Pa. 1990); *Everson v. Blue Cross & Blue Shield*, No. 93CV7534, 1994 WL 675200, *12-13 (N.D. Ohio 1994); *Richhart v. Metropolitan Life Ins. Co.*, 1990 U.S. Dist. LEXIS 3597, *5-7 (E.D. Pa. 1990).

the McCarran-Ferguson Act. *Ambrose v. Blue Cross & Blue Shield of VA, Inc.*, ____ F. Supp. ____, 1995 WL 385165, *15-16 (E.D. Va. 1995); *see infra* at pp. 18-20.

This pronounced conflict in the cases concerning the application of an important federal statute deserves this Court's attention, and it is a question of "when," not "if," this Court will have to take up the issue and resolve the conflict. Until resolved, however, that conflict will result in the uneven and arbitrary application of McCarran-Ferguson, for whether RICO can be applied in this context often will be dictated merely by whether a lawsuit is filed in federal court, which may follow the opinion here, or a state court, which may follow cases such as *American Int'l Group*.

This Court should act now to forestall a proliferation of conflicting decisions, provide the guidance the lower state and federal courts need, and avoid countless hours of litigation over the threshold question of whether RICO even applies. The issue is squarely presented here, is ripe for decision, and petitioners therefore respectfully urge this Court to grant certiorari.

2. The Ninth Circuit's Opinion Misconstrues McCarran-Ferguson, Resulting In An Erroneous Expansion Of Federal Authority Over The Business Of Insurance

Although the conflict in the cases alone warrants this Court's attention, certiorari also is warranted because the Court of Appeals' narrow reading of the phrase "invalidate, impair, or supersede" does not withstand scrutiny as a matter of statutory construction and thus distorts the meaning and effect of an important federal law. Under the plain meaning of the statutory language, there does not have to be an actual or a direct conflict between federal law and a state law which regulates the business of insurance before McCarran-Ferguson applies.

" '[T]he starting point in a case involving construction of the McCarran-Ferguson Act, like the starting point in any case involving the meaning of a statute, is the language of the statute itself.' " *Fabe*, 113 S. Ct. at 2207-08. To be sure, application of such a directly conflicting federal law would "invalidate, impair, or supersede" state law. But if Congress had intended to bar application of only conflicting federal laws, it would have said so directly. Instead, McCarran-Ferguson is couched in terms that must carry a broader meaning than direct conflict. The word "impair" means "to damage, injure, diminish, prejudice, undermine or weaken." *Brownell v. State Farm Mut. Ins. Co.*, 757 F. Supp. 526, 536 n. 13 (E.D. Pa. 1991) (citing Webster's New Collegiate Dictionary (9th ed. 1988) and Webster's Collegiate Thesaurus (1976)). The word "supersede" connotes making something "superfluous or unnecessary" by supplanting it with something else. Webster's Third New International Dictionary 2295 (1986). In light of these ordinary and accepted meanings of the words Congress used instead of "direct conflict," the routine assertion of RICO claims, which will be inevitable following the Ninth Circuit's opinion, will of necessity impair and supersede state regulatory schemes.

California and all but a few other states rely on a comprehensive mix of statutory and common law principles, enforced by administrative and private actions, to regulate the business of insurance. *See Manufacturers Life Ins. Co. v. Superior Court*, 41 Cal. Rptr. 2d 220, 230-31 (Cal. 1995); *Moradi-Shalal v. Fireman's Fund Ins. Cos.*, 250 Cal. Rptr. 116, 121 (Cal. 1988). In California, for example, the Legislature expressly intended to regulate the business of insurance to the greatest extent possible under McCarran-Ferguson. Cal. Ins. Code § 790; *Manufacturers Life Ins. Co.*, 41 Cal. Rptr. 2d at 229 (California's Unfair Insurance Practices Act was enacted with the "acknowledged purpose . . . to preclude federal jurisdiction over the business of insurance"). To that end, California's Unfair Insurance

Practices Act lists the types of practices that are proscribed and contains a full remedial scheme exclusively administered by the Department of Insurance. *See* Cal. Ins. Code §§ 790.03 *et seq.*; *Moradi-Shalal*, 250 Cal. Rptr. at 126 (holding that violation of these statutes does not give rise to an implied right of action); *see also American Int'l Group*, 285 Cal. Rptr. at 777. This regulatory scheme also exists on top of the full panoply of common law rights and remedies afforded by California law — rights that Merchants is presently pursuing in state court. (*See supra* p. 5, n. 1) Given these layers of California law effectively regulating the business of insurance, this Court cannot assume that the California Legislature anticipated, or would approve of, the addition of another layer of federal remedies — such as treble damages and attorney fees — it did not see fit to provide.[5] *See American Int'l Group*, 285 Cal. Rptr. at 777; *Gordon*, 868 F. Supp. at 1196-97; *Forsyth*, 827 F. Supp. at 1520-22.

Consequently, the availability of a mandatory award of treble damages and attorney fees under RICO [18 U.S.C. § 1964(c)] would significantly reduce the need for a litigant to rely on state laws that regulate the business of insurance. But where state law is not invoked, or at least takes a back seat to federal law, a state's ability to regulate the business of insurance effectively is jeopardized. In that sense, the routine application of RICO would necessarily supplant state law by diminishing its importance as the primary

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[5]The result does not change because punitive damages are available in California. Punitive damages are discretionary, vary in amount, and can be imposed only if the plaintiff meets a rigorous statutory standard by clear and convincing evidence. *See* Cal. Civ. Code § 3294; *College Hosp., Inc. v. Superior Court*, 34 Cal. Rptr. 2d 898, 908 (Cal. 1994); *Adams v. Murakami*, 284 Cal. Rptr. 318, 320-21 (Cal. 1991).

source for regulation of the business of insurance.[6] That impact on state law, in turn, is all that is — or should be — required for McCarran-Ferguson to apply. *American Int'l Group,* 285 Cal. Rptr. at 777; *Ambrose,* 1995 WL 385165, *15 ("the disparity between the cause of action and remedy permitted by RICO and the enforcement mechanism and remedy permitted by Virginia's insurance code [is] so great that the federal law would in fact supersede the state law"); *see Fabe,* 113 S. Ct. at 2207 (McCarran-Ferguson enacted because Congress wanted to "restore the supremacy of the states" with respect to regulation of the business of insurance).

The Ninth Circuit apparently bypassed this analysis, however, and relied instead on the Seventh Circuit's *NAACP* decision as the sole authority for its holding that McCarran-Ferguson did not preempt civil RICO claims aimed at the business of insurance. That reliance was misplaced because the reasoning in *NAACP* is flawed. The question in *NAACP* was whether McCarran-Ferguson barred application of the federal Fair Housing Act (FHA) to insurance companies that allegedly engaged in "redlining" when issuing homeowners insurance policies. One part of the opinion focused on whether application of the FHA would "invalidate, impair, or supersede" the relevant state law. In that regard, the *NAACP* Court started with the

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[6]Merchants and its amici have argued here that the availability of RICO claims will actually assist the states in regulating improper insurance practices. That argument begs the question, for it is not grounded in the language or history of the McCarran-Ferguson Act. Indeed, if the states truly need more assistance, then the answer is not to pretend that McCarran-Ferguson is an anachronism in the law. Rather, the answer would be to persuade Congress to repeal McCarran-Ferguson, amend RICO to expressly apply it to the business of insurance, or enact other laws that have the specific purpose of regulating the business of insurance. *See* 15 U.S.C. Section 1013 (exempting certain laws from the impact of McCarran-Ferguson).

premise that "even thoroughgoing federal regulation" usually does not impliedly preempt state law regulating the same activity. 978 F.2d at 296. It then stated — without offering any supporting analysis — that because the "McCarran-Ferguson Act is a form of inverse preemption . . . principles defining when state remedies conflict with (and so are preempted by) federal law are pertinent," *Id.*

But in so framing the issue it decided, the *NAACP* Court overlooked the fundamental differences between implied preemption principles on the one hand and McCarran-Ferguson on the other. *See Ambrose*, 1995 WL 385165, *16. When the question is whether federal law impliedly preempts state law, the courts routinely *presume* that state law may regulate the conduct in question unless the party urging implied preemption shows that state law actually conflicts with the goals and objectives of federal law. *California v. ARC America Corp.*, 490 U.S. 93, 101 (1989); *Chemical Specialties Mfrs. Ass'n, Inc. v. Allenby*, 958 F.2d 941, 943 (9th Cir.), *cert. denied,* 113 S. Ct. 80 (1992). Because state sovereignty is at stake, absent such a conflict the courts uphold and respect state laws that may parallel federal law or provide additional rights and remedies. *E.g., English v. General Elec. Co.*, 496 U.S. 72, 82-90 (1990). These principles thus limit the scope of implied preemption and, by making it *more difficult* for federal law to preempt state law, make it *easier* for state law to apply alongside federal law.

The very purpose of McCarran-Ferguson, however, is to *reserve to the states* broad regulatory control over the business of insurance without the intrusion of general federal laws regulating various aspects of interstate commerce. *SEC,* 393 U.S. at 459; *Western & S. Life Ins. Co. v. State Bd. of Equal.*, 451 U.S. 648, 654 (1981); *see* discussion *supra* at pp. 8-10. In enacting McCarran-Ferguson, Congress indisputably intended to make it *easier* for the states to

regulate the business of insurance *without* federal encroachment and thereby to make it *more difficult* for federal law to apply alongside state law. *See Prudential Ins. Co.*, 328 U.S. at 429-30. Yet if McCarran-Ferguson preemption operates only when federal and state law actually or directly conflict, the effect will be to significantly reduce — not enlarge or enhance — the sphere of state sovereignty over the business of insurance.

Simply put, the *NAACP* Court asked the wrong question. In construing the phrase "invalidate, impair or supersede," a court cannot — and should not — stop with a determination that there is no "actual conflict" between state and federal law. Rather, because Congress wanted to enhance the likelihood that the states would be able to regulate the business of insurance without encroachment by federal law, logic and the holding of *FTC* show that a different analytical model must be employed for McCarran-Ferguson preemption. In that respect, the controlling law should be derived from cases involving express preemption.

In *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41, 53-54 (1987), for example, this Court construed ERISA's preemptive scope by emphasizing that Congress intended to provide a comprehensive system of rights and remedies for ERISA plan beneficiaries that had the effect of excluding state law rights and remedies, whether they be conflicting, parallel, or cumulative. *Cf. FTC*, 357 U.S. at 563 (McCarran-Ferguson preemption precludes even "supplemental" federal regulation). Further, because ERISA contained this comprehensive remedial scheme, these additional remedies unavoidably would interfere with and disrupt federal law. *Pilot Life*, 481 U.S. at 54. By analogy, therefore, the first question a court should ask in a McCarran-Ferguson case is whether the state has acted to comprehensively regulate the business of insurance. Where such a comprehensive scheme exists, cases like *Pilot Life* also show what the next step in

the analysis should be. A court should *not* assume that a state that has enacted a comprehensive regulatory system nevertheless contemplated that federal law would be imported to augment this regulatory framework whenever it could be characterized as not being in actual conflict with an express provision of state law. *Compare Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 386 (1992) (even consistent state law is expressly preempted by the Airline Deregulation Act because federal law is controlling); *Mackey v. Lanier Collection Agency & Serv., Inc.*, 486 U.S. 825, 829 (1988) (same under ERISA).

By employing a flawed analytical approach, the Ninth Circuit's interpretation of McCarran-Ferguson will result in more, not less, federal regulation of the business of insurance. Not only will this flawed reasoning allow RICO claims to be asserted in cases like this one, but it will open the door to application of other federal laws that, although they have nothing to do with insurance, prohibit conduct which is also illegal under state law. That cannot have been the result Congress intended, but this expansion of federal sovereignty over the business of insurance will continue unabated until this Court acts. Certiorari is warranted for this reason as well.

3. The Ninth Circuit's Opinion Will Disrupt The States' Regulation Of Insurance And Frustrate The Intent Of Congress

There is a further and compelling need for this Court's review: The importance of the issue presented is underscored by the fact that the Court of Appeals' opinion goes a long way toward "federalizing" insurance disputes. Given the frequency with which RICO claims already have been alleged in insurance cases and are alleged in non-insurance actions, RICO counts will be standard items in what otherwise would be breach of insurance contract lawsuits

governed solely by state law. Experience shows that when given the choice, plaintiffs and their counsel will rarely, if ever, forego the opportunity to recover on a theory that mandatorily imposes treble damages and attorney fees. Further, because RICO provides federal question jurisdiction, the availability of that cause of action will, as in this case, be the sole reason why the federal district courts will increasingly become the forum for lawsuits like this one. (App. 2a, 10a) *E.g., Senich v. Transamerica Premier Ins. Co.*, 766 F. Supp. 339 (dismissing complaint containing state law claims for lack of federal jurisdiction after concluding that McCarran-Ferguson barred the plaintiff's RICO claims).

The inevitable effect of the Ninth Circuit's decision will be that McCarran-Ferguson will *not* bar this onslaught of RICO claims that involve the business of insurance and are made against insurance companies or insurance brokers. Thus, while Congress in effect chose a "hands off" policy toward the regulation of the business of insurance, the opinion here makes Congress and the federal courts de facto regulators of that activity. This "federalization" of insurance litigation is plainly irreconcilable with the express purpose of McCarran-Ferguson. (*See supra pp. 8-10*)

At the same time, insurance companies and insurance brokers will now face considerable uncertainty over what federal laws may apply in addition to state laws regulating the business of insurance. Given the Ninth Circuit's approach, an insurer's and insurance broker's compliance with state law will no longer provide them with the assurance that they have fully complied with the law, and they must at least consider all federal laws that may not conflict with state law but nevertheless represent an additional layer of insurance regulation. That will be true, moreover, even though Congress did not enact these laws contemplating that they would be applied to regulate the business of insurance.

Finally, subjecting insurers and insurance brokers to RICO's threat of treble damages and attorney fees — threats they usually do not face under state law — cannot help but disrupt the insurance market by driving up the cost of insurance. Even if the likelihood of exposure in a RICO claim is low, the mere potential for a crushing damages award will compel insurers to settle claims they otherwise could have successfully defended. Those extra settlements will exact their own costs in the form of increased premiums for other insureds. *See Garvey v. State Farm Fire & Cas. Co.*, 257 Cal. Rptr. 292, 299 (Cal. 1989). Because the cost of insurance is central to the states' regulation of insurance, the imposition of new and costly forms of liability ought to come from the states — not from Congress — at least where Congress has merely enacted a law of general applicability rather than one aimed at the business of insurance.

The applicability of McCarran-Ferguson in this context presents a question of nationwide importance to the states' ongoing ability to regulate the business of insurance as Congress intended. Unless this Court acts, there will be a sea change in how the courts apply McCarran-Ferguson. Unless this Court acts, Congress and the federal courts are going to become — virtually by default — active regulators of the business of insurance. The importance of these questions likewise justifies granting certiorari.

B. Whether The Phrase "Business Of Insurance" Should Be Narrowly Construed, Thereby Making Congress And The Federal Courts De Facto Regulators Of The Business Of Insurance, Is An Issue Of Nationwide Importance On Which There Is A Conflict In The Cases

Certiorari is also warranted to examine the Ninth Circuit's holding that the "business of insurance" is present for

purposes of McCarran-Ferguson only if there is an actual transfer of risk from the insured to an insurer. According to the Court of Appeals, the handling of self-insured claims and charging for policies that did not exist could not be part of the business of insurance because standing alone those activities did not result in a transfer of risk. That holding appears to be in conflict with this Court's decision in *Fabe*, and this Court should review the Ninth Circuit's opinion before its approach erroneously restricts application of McCarran-Ferguson in other cases.

1. The Ninth Circuit's Opinion Is In Apparent Conflict With This Court's Decision In *Fabe* Because It Narrowly Interprets The Phrase "Business Of Insurance" To Always Require A Transfer Of Risk

The question in *Fabe* was whether a state statute that determined the order of priority of claims in the event of an insurer's insolvency was a law enacted "for the purpose of regulating the business of insurance." *See* 15 U.S.C. § 1012(b). In analyzing that issue, this Court held there was a significant difference between that phrase and the antitrust proviso in the second part of Section 1012(b), which refers only to the "business of insurance."[7] Because of this difference in statutory language, a law enacted "for the purpose of regulating the business of insurance" is broader in scope than the business of insurance itself, and includes those laws that "possess the 'end, intention, or aim' of adjusting,

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[7]Where the antitrust proviso is involved, the question whether an activity is within the scope of the "business of insurance" requires consideration of a three-part test: (1) whether the practice has the effect of transferring or spreading a policyholder's risk; (2) whether the practice is an integral part of the policy relationship between the insurer and insured; and (3) whether the practice is limited to entities within the insurance industry. *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 129 (1982); *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 210 (1979).

managing or controlling the business of insurance." *Fabe*, 113 S. Ct. at 2210, quoting Black's Law Dictionary 1236, 1286 (6th ed. 1990). Further, in this context the focus should be on the overall relationship between the policyholder and the insurer, which contemplates more than the bare issuance of an insurance policy. *Fabe*, 113 S. Ct. at 2208; *see SEC*, 393 U.S. at 460 ("Statutes aimed at protecting or regulating [the policyholder-insurance company] relationship, directly or indirectly are laws regulating the 'business of insurance.' ")

Under *Fabe*'s holding and approach, there seems little question that the parties' relationship and the insurance brokerage activities involved here directly or indirectly implicated the business of insurance and were made possible only because petitioners were engaged in the business of insurance. This plainly is *not* a situation where the only activity involved was claims handling for a self-insured entity or some other transaction that is completely on the periphery of the business of insurance. *Compare Moore v. Provident Life & Acc. Ins. Co.*, 786 F.2d 922 (9th Cir. 1986) (insurer was acting solely as a third-party administrator for a labor union's self-funded health benefits plan). Rather, as the district court emphasized, Merchants' complaint makes it clear that it authorized the two individuals involved to act as its exclusive insurance brokers precisely because they could negotiate, place and oversee insurance coverage as well as provide related risk management services. (*See* ER 14-15) *All* the misconduct alleged here occurred while delivering services that were part of the business of insurance. Further, those alleged acts of misconduct *are* subject to California's statutory scheme, which without question has the "end, intention, or aim" of regulating the business of insurance. *See* Cal. Ins. Code § 790 *et seq.*; *Manufacturer's Life Ins. Co.*, 41 Cal. Rptr. 2d at 229.

Fabe and the Ninth Circuit's opinion point in different directions. *Fabe* makes it clear that a court must consider the overall relationship between the parties and that a law can be enacted "for the purpose of regulating the business of insurance" even though the act regulated by itself does not transfer risk. The Ninth Circuit, in contrast, looks at the relationship piecemeal, so that the sum of its parts is less than the whole. By artificially circumscribing the scope of laws enacted for "the purpose of regulating the business of insurance," that piecemeal approach will minimize the states' role in regulating the business of insurance, contrary to *Fabe* and McCarran-Ferguson.

2. The Ninth Circuit's Opinion Will Create Confusion And Uncertainty In An Area Where Congress Has Mandated Certainty And Predictability Through State Regulation

By disregarding the overall context in which the alleged acts of misconduct took place, the Ninth Circuit's insistence that the business of insurance exists only if the activity involved directly relates to an existing insurance policy will lead to more unnecessary and troublesome confusion over when insurance activities are part of the business of insurance.

Here, for example, the Ninth Circuit correctly held that fraudulent premium overcharges were part of the business of insurance. Another court could, however, justify the opposite result by reasoning that the excessive portion of the premium, which should never have been charged in the first place, really transferred no risk at all. Following the approach of the Ninth Circuit's opinion here, a court could also conclude that the business of insurance was not involved where an insurer or broker allegedly misrepresented that a policy would cover a certain risk on the ground that, as to that risk only, no transfer of risk actually occurred. The same could be said anytime particular coverages are can-

celled, withdrawn, changed or erroneously represented to be available or unavailable. In each instance, the discrete acts involved do not literally involve the transfer of risk, but there can be no dispute that the business of insurance is involved.

Just as with the RICO issue, the Ninth Circuit's construction of the "business of insurance" issue finds no support in this Court's decisions, will produce confusion over the scope of McCarran-Ferguson, and will engender litigation over whether traditional insurance and risk management activities are within the business of insurance. Because conflicting rulings are sure to follow, this Court should grant certiorari to make clear that it meant what it said in *Fabe* and to put McCarran-Ferguson law back on its proper course.

VI

CONCLUSION

Petitioners respectfully urge this Court to grant certiorari in order to resolve conflicts in the cases and to provide clarity in this important area where state and federal law intersect. The questions presented here are at the core of the fundamental purposes of the McCarran-Ferguson Act, and whether RICO can be applied to the business of insurance is one of the most frequently litigated issues under that Act today. Further, the reasoning of the Court of Appeals' opinion conflicts with this Court's opinions on the scope of the McCarran-Ferguson Act, exacerbates a nationwide split on whether that Act bars civil RICO claims, and will engender confusion and uncertainty over the correct role federal law has regarding regulation of the business of insurance.

DATED: September 1, 1995.

CROSBY, HEAFEY, ROACH & MAY
Professional Corporation

By _____
James C. Martin
Attorneys for Petitioners

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

MERCHANTS HOME DELIVERY SERVICE, INC., a California corporation,
Plaintiff,
vs.
RELIANCE GROUP HOLDINGS, INC., a Delaware corporation, et al.,
Defendants.

No. CV-92-6889-WMB

ORDER

I. BACKGROUND

Plaintiff Merchants Home Delivery Service ("MHDS") asserts that, through an elaborate scheme, the defendants defrauded them of insurance premiums either through overcharging MHDS for the insurance coverage that was obtained for it or by never obtaining insurance coverage that was prepaid. The Amended Complaint alleges that a group of individual defendants conspired together to defraud the plaintiff and others. It also alleges that the individual defendants used the firms they worked at to facilitate the fraudulent scheme. Some of these firms and their successors in interest are the Prometheus defendants who have brought this motion for a judgment on the pleadings.[1] Two of the

[1] The defendants included as the Prometheus Defendants are: PROMETHEUS FUNDING CORP., (erroneously named as "Prometheus Liquidating Corp." and successor to the now defunct named defendant "FRANK B. HALL & CO., INC." a Delaware corporation), FRANK B. HALL INSURANCE BROKERS, INC., a New York corporation, (formerly dba FRANK B. HALL & CO. OF CALIFORNIA INSUR-

defendants are or were under criminal indictment for fraudulent activities.[2]

Plaintiff originally alleged nine causes of action against the defendants. The first two claims alleged violations of civil RICO. 18 U.S.C. § 1962(c)-(d). The remaining seven causes of action were pendent state claims which the Court dismissed without prejudice in April, 1993.

The Prometheus defendants bring this motion for a judgment on the pleadings pursuant to section 12(c) of the Federal Rules of Civil Procedure. Defendants allege that the remaining two RICO claims are barred by the provisions of the McCarran-Ferguson Act, 15 U.S.C. § 1012(b).

II. DISCUSSION

A. Standard

Under Fed. R. Civ. P. 12(c), a party is entitled to a judgment on the pleadings where no issues of material fact exist and the moving party is entitled to a judgment as a matter of law. It is almost identical to a 12(b)(6) motion for failure to state a claim, in that the Court is to view the facts presented in the pleadings "in the light most favorable to the plaintiffs, accepting as true all of the allegations in their complaint and treating as false those allegations in the answer that contradict the plaintiffs' allegations." *Hoeft v.*

ANCE BROKERS, a division of FRANK B. HALL INSURANCE BROKERS, INC., and "FRANK B. HALL & CO." and FRANK B. HALL & CO. OF CALIFORNIA, dba "BALDEN, CARTER & VILES" and "FLETCHER, LAWRENCE, PRUETER & DODDS"), AON CORPORATION, ROLLINS HUDIG HALL and ROLLINS HUDIG HALL OF SOUTHERN CALIFORNIA, INC.

[2]One of the defendants under indictment, Ismay, entered into a plea of guilty and was sentenced to 4 years confinement. The other defendant, Smalridge, based upon the last information presented to the Court, was scheduled for trial in early July.

Tucson Unified School Dist., 967 F.2d 1298, 1301 n.2 (9th Cir. 1992).

The Court should not grant a judgment under Rule 12(c) unless "it is clear that the merits of the controversy can be fairly and fully decided in this summary manner." 5A C. Wright & A. Miller, *Federal Practice and Procedure*, § 1369, at 534-535 (1990 and 1992 Supp.).

B. Whether the McCarran-Ferguson Act Bars MHDS's RICO Claims

The McCarran-Ferguson Act was passed by Congress in 1945 to statutorily reverse *United States v. South-Eastern Underwriters Association*, 64 S.Ct. 1162 (1944), which held that the business of insurance was subject to all federal laws. The McCarran-Ferguson Act states:

> No Act of congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance.

15 U.S.C. § 1012(b). The Congressional purpose behind the Act was to give states primary jurisdiction over the regulation of the business of insurance. *Cochran v. Paco, Inc.*, 606 F.2d 460, 463 (5th Cir. 1979).

The Fifth Circuit case of *Cochran v. Paco, Inc., supra*, establishes the test used to determine the applicability of the McCarran-Ferguson Act. *Cochran* held that the McCarran-Ferguson Act bars the application of a federal statute where:

(1) the federal statute does not relate specifically [to] the business of insurance;

(2) the complained of activities constitute the business of insurance;

(3) the state has enacted laws for the purpose of regulating the complained of activity; and

(4) the application of the federal statute would invalidate, impair or supersede state legislation.

Cochran, 606 F.2d at 464 (adopting analysis of *Securities & Exchange Comm'n v. National Securities, Inc.*, 89 S.Ct. 564, 567-569 (1969)); *see also LeDuc v. Kentucky Central Life Insurance Company*, 814 F. Supp. 820, 826-27 (NB.D. Cal. 1992) (citing *Cochran*); *American International Group, Inc. v. Superior Court*, 285 Cal. Rptr. 765 (1991) (same).

1. Whether RICO specifically relates to the business of insurance

The point is not disputed. RICO clearly does not specifically address the business of insurance.

2. Whether the conduct in the complaint constitutes the business of insurance

The interpretation of what constitutes the "business of insurance" is a federal question and the "federal interpretations supersede those of state courts." *Securities & Exchange Comm'n v. Variable Annuity Life Ins. Co.*, 79 S.Ct. 618, 621 (1959). The United States Supreme Court has stated that the marketing, advertising, sale and performance of insurance policies constitutes the "business of insurance." *FTC v. National Casualty Co.*, 78 S.Ct. 1260 (1958).

The Supreme Court has listed three elements to be considered in determining whether activity constitutes the business of insurance; (1) whether the practice has the effect of transferring or spreading a policyholder's risk; (2) whether the practice is an integral part of the policy relationship between the insurer and the insured; and (3) whether the practice is limited to entities within the insurance industry. *Group Life & Health Ins. Co. v. Royal Drug Co.*, 99 S.Ct. 1067 (1979). These factors are not binding: "no one is dispositive, rather each is instructive." *United*

Food & Commercial Workers v. Pacyga, 801 F.2d 1157, 1161 (9th Cir. 1986).

MHDS argues that the practices alleged in this case fall into two categories. The first category asserted is soliciting and obtaining "insurance premium" payments from MHDS for nonexistent, fictitious policies and pocketing the money.[3] The second category asserted is overcharging MHDS on real, existing insurance policies, and pocketing the difference between the true premium amount and the amount charged.[4] MHDS argues that these activities do not satisfy the factors set out in *Royal Drug* and therefore do not constitute engaging in the business of insurance.

MHDS did not separate its allegations against the defendants into these two neat categories until recently when it did so in its attempt to circumvent the McCarran-Ferguson Act. MHDS's Amended Complaint alleges that the defendants "conceived the idea of using their insurance brokerage business . . . as a platform from which to swindle and bilk their insurance customers of premium payments . . ." (Amended Complt. p. 12) and then convinced MHDS to switch all of its insurance programs and business to the defendants. (*Id.* at 14). MHDS alleges that, in 1986, defendants made a proposal to provide insurance services to MHDS and that MHDS accepted this insurance proposal (*Id.*). The Amended Complaint also alleges that for each successive year, defendants made insurance renewal proposals which MHDS accepted. (*Id.* at 15).

In addition, the amended Complaint asserts that defendants instituted a pass-through procedure so the billing and invoicing for MHDS's insurance premiums would go di-

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[3]MHDS alleges that the amount it was defrauded through this activity was at least $979,493.

[4]MHDS alleges that the amount it was defrauded through this activity was at least $309,421.

rectly to the defendants from the other insurance carriers. (*Id.* at 16). MHDS claims this was done so that defendants could misrepresent premiums, overbill for insurance coverage, bill for insurance coverage not provided, set excess estimated premiums, misrepresent the amount and/or validity of the claims, and retain funds due to MHDS. (*Id.* at 17).

It is clear that the actual allegations contained in the Amended Complaint assert more than just two simple categories of fraud. Rather, the allegations assert a broad scheme in which the defendants committed fraud within the insurance industry. Therefore, an analysis of the *Royal Drug* factors are not necessary since the allegations against the defendants fall squarely within the definition of marketing and sale of insurance policies. However, as an alternative basis, the Court provides an analysis of the *Royal Drug* factors.

a. Whether the practice has the effect of transferring or spreading a policyholder's risk

The Ninth Circuit has characterized the transferring or spreading of a policyholder's risk as "the primary characteristic of the business of insurance." *Feinstein v. Nettleship Co. of Los Angeles*, 714 F.2d 928, 931 (9th Cir. 1983).

MHDS argues that neither of the activities that it alleges defendants participated in operate to spread policyholders' risk. MHDS asserts that the transfer of risk is "effected by means of the contract between the parties — the insurance policy — and that transfer is complete at the time that the contract is entered." *Union Labor Life Ins. Co. v. Pireno*, 102 S.Ct. 3002, 3009 (1982). Here, MHDS contends, the parties never entered a contract with regard to the first category of fraud because defendants took the money and never gave MHDS the policy. As for the second category, MHDS argues that the defendants overcharging it for the

premiums is unconnected to the transfer of risk accomplished when the contract was entered.

The Court disagrees with MHDS. MHDS alleges in its Amended Complaint that defendants, as insurance brokers, made policy renewal proposals, billed and invoiced MHDS for the insurance policy premiums and accepted the insurance premiums. These are classic activities in the insurance industry that operate to spread the risk. Moreover, the payment of the insurance premiums in return for policies, even if overpriced as alleged, still is a practice that effectuates the transfer of risk.

b. Whether the practice is an integral part of the policy relationship between the insurer and the insured

MHDS argues that a broker taking money and giving nothing in return or a broker overcharging for coverage can never be considered an integral part of the insurer-insured relationship. In addition, MHDS asserts that, as brokers, the defendants are not insurers and therefore are not an integral part of the insurance relationship. Finally, MHDS asserts that it was a victim, not an insured, because the premiums paid did not yield an insurance policy. Therefore, MHDS asserts, there is no insurer-insured relationship present in this case.

Under California Insurance Code § 33, an insurance broker in California transacts insurance. Brokers are the middlemen and, as such, they form an integral part of the insurance relationship. It is alleged that the defendants made insurance policy renewal proposals, billed and invoiced MHDS for the policy premiums, and accepted the premiums. As pointed out by the defendants, the broker markets, advertises and sells policies for the insurer, negotiates coverage and obtains policies for the insured, and accepts premiums. This satisfies the McCarran-Ferguson

Act requirement that the broker be involved in the business of insurance.

c. Whether the practice is limited to entities within the insurance industry

MHDS asserts that the case fails this prong because the type of fraud engaged in by defendants is not limited to the insurance industry. MHDS argues that the fraud in this case is the same as a real estate scheme where a broker receives money and does not provide any property in return. The fact that it is insurance policies, MHDS contends, is tangential and does not operate to satisfy this prong of the *Royal Drug* test.

Once again, MHDS is attempting to read its Amended Complaint more narrowly than it is written. The Amended Complaint alleges the defendants were brokers who made insurance policy renewal proposals, obtained the renewals, and accepted the insurance premiums. These alleged activities are by definition limited to the insurance industry.

d. Conflict in the district courts

There are two competing cases in the California district courts that directly address whether insurance-related activities involving fraud fall within the business of insurance.

In *LeDuc v. Kentucky Central Life Insurance Co.*, 814 F.Supp. 820 (N.D. Cal. 1992), the district court examined insurance agents' claims that the insurance company they represented engaged in fraudulent practices to induce agents to sell more insurance and investments at higher premiums. The court held that the McCarran-Ferguson Act barred the insurance agents' claims because the insurer's "alleged fraudulent activity is . . . within the business of insurance because it is directed at the purchasing public and is intended to induce the purchase of insurance." *LeDuc*, 814 F.Supp. at 827.

The court in *Thacker v. New York Life Insurance Co.*, 796 F.Supp. 1338, 1342 (E.D. Cal. 1992), found that insurance-related activity was not within the "business of insurance" when the activity involved fraud. The court reasoned that the person committing the fraud could "hardly be heard to assert that mail fraud is the ordinary business of insurance." *Thacker*, 796 F.Supp. at 1342.

The Court finds the *LeDuc* reasoning more persuasive. If courts followed the *Thacker* analysis, the McCarran-Ferguson Act would never act to bar a federal statute because the wrongdoing would always be outside the ordinary course of the business of insurance. This would subvert the policy behind the McCarran-Ferguson Act which was to allow states to regulate the insurance industries.

3. Whether California has enacted laws for the purpose of regulating the type of activity complained of in this case

California has a statute that was passed in direct response to the McCarran-Ferguson Act. California Insurance Code § 790 states:

> The purpose of this article is to regulate trade practices in the business of insurance in accordance with the intent of Congress as expressed in the [McCarran-Ferguson Act], by defining, or providing for the determination of, all such practices in this State which constitute unfair methods of competition or unfair or deceptive acts or practices and by prohibiting the trade practices so defined or determined.

This Act applies to brokers. Cal. Ins. Code § 790.01.

MHDS argues that this Act is not applicable because it does not purport to regulate misrepresentations about the very existence of insurance policies. The Court rejects this argument. Section 790 regulates all trade practices in the

business of insurance. Specifically, the Act prohibits the making of any misrepresentation "regarding the terms of any policy issued or to be issued or the benefits or advantages promised thereby." Cal. Ins. Code § 790.03. The First Amended Complaint alleges that defendants accepted premiums for policies and coverage that MHDS did not receive. If MHDS thought it was supposed to receive a policy or certain coverage by way of a policy, the logical implication is that it was because it was told something false about the policies by the defendants. This type of misrepresentation is directly regulated by the Insurance Code.

4. Whether the application of RICO would invalidate, impair or supersede state legislation

RICO contains provisions for treble damages and attorneys' fees, neither of which is allowed under the California statutory scheme. Therefore, RICO would not just provide "parallel" remedies as asserted by MHDS. It would supersede the state remedies.

III. CONCLUSION

The Prometheus defendants' motion for judgment on the pleadings is granted. The RICO causes of action are barred by the McCarran-Ferguson Act: (1) RICO is not a federal insurance statute; (2) the defendants are alleged to have acted in the business of insurance; (3) California has a comprehensive statutory scheme covering the alleged conduct; and (4) allowing RICO to operate would supersede the state statutory scheme. If MHDS wants to pursue its claims against the defendants, it should do so in state court.

DATED: July 24, 1993.

Wm. Matthew Byrne, Jr.
United States District Judge

NOT FOR PUBLICATION
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

Filed
June-8 1995
Cathy A. Catterson, Clerk
U.S. Court of Appeals

MERCHANTS HOME DELIVERY SERVICE, INC., a California corporation,
Plaintiff-Appellant,
v.
FRANK B. HALL & CO., INC., a Delaware corporation; PROMETHEUS LIQUIDATING CORP., a Delaware corp.; FRANK B. HALL INSURANCE BROKERS, INC., a Delaware corp.; JAMES DWIGHT ISMAY, an individual; TERRY DON SMALRIDGE, an individual; PAUL C. CARTER, an individual,
Defendants-Appellees.

No. 93-56302
D.C. No.
CV-92-06889-WMB

MERCHANTS HOME DELIVERY SERVICE, INC., a California corporation,
Plaintiff-Appellant,

v.

FRANK B. HALL & CO., INC., a Delaware corporation; PROMETHEUS LIQUIDATING CORP., a Delaware corporation; FRANK B. HALL INSURANCE BROKERS, INC., a Delaware corporation,
Defendants,

and

PAUL C. CARTER, an individual,
Defendant-Appellee.

No. 93-56589

D.C. No. CV-92-06889-WMB (V)

MERCHANTS HOME DELIVERY SERVICE, INC., a California corporation,
Plaintiff-Appellant,
v.
FRANK B. HALL & CO., INC., a Delaware corporation; PROMETHEUS LIQUIDATING CORP., a Delaware corp.; FRANK B. HALL INSURANCE BROKERS, INC., a Delaware corp.; JAMES DWIGHT ISMAY, an individual; TERRY DON SMALRIDGE, an individual,
Defendants-Appellees,
and
PAUL C. CARTER, an individual,
Defendant.

No. 94-55035
D.C. No.
CV-92-06889-WMB(T)

ORDER

Before: BROWNING, BOOCHEVER and BEEZER, Circuit Judges.

The panel has voted unanimously to deny the petition for rehearing. Judges Browning and Beezer vote to reject the suggestion for rehearing en banc and Judge Boochever so recommends.

The full court has been advised of the suggestion for rehearing en banc and no judge in active service has requested a vote to rehear the matter en banc. Fed. R. App. P. 35.

The petition for rehearing is DENIED and the suggestion for rehearing en banc is REJECTED.

COURT OF APPEALS OPINION

MERCHANTS HOME DELIVERY SERVICE, INC.,
a California corporation,
Plaintiff-Appellant,

vs.

FRANK B. HALL & CO., INC., a Delaware corporation;
PROMETHEUS LIQUIDATING CORP., a Delaware corp.;
FRANK B. HALL INSURANCE BROKERS, INC., a Delaware corp.; JAMES DWIGHT ISMAY, an individual;
TERRY DON SMALRIDGE, an individual;
PAUL C. CARTER, an individual,
Defendants-Appellees,

MERCHANTS HOME DELIVERY SERVICE, INC.,
a California corporation,
Plaintiff-Appellant,

vs.

FRANK B. HALL & CO., INC., a Delaware corp;
PROMETHEUS LIQUIDATING CORP., a Delaware corp.;
FRANK B. HALL INSURANCE BROKERS, INC.,
a Delaware corporation,
Defendants,

and

PAUL C. CARTER, an individual,
Defendant-Appellee.

MERCHANTS HOME DELIVERY SERVICE, INC.,
a California corporation,
Plaintiff-Appellant,

vs.

FRANK B. HALL & CO., INC., a Delaware corporation;
PROMETHEUS LIQUIDATING CORP., a Delaware corp.;
FRANK B. HALL INSURANCE BROKERS, INC.,
a Delaware corp.;

JAMES DWIGHT ISMAY, an individual;
TERRY DON SMALRIDGE, an individual,
Defendants-Appellees,

and

PAUL C. CARTER, an individual,
Defendant.
Nos. 93-56302, 93-56589, 94-55035.

United States Court of Appeals, Ninth Circuit,
Argued and Submitted, March 8, 1995
Decided March 28, 1995.

Before: BROWNING, BOOCHEVER and BEEZER, Circuit Judges.

BEEZER, Circuit Judge:

Plaintiff Merchants Home Delivery Service, Inc. ("Merchants") appeals the district court's judgments dismissing Merchants' action against its former insurance broker, Frank B. Hall & Co., Inc. and associated defendants (collectively "Hall"). Merchants' complaint asserts claims under the Racketeer Influenced and Corrupt Organizations Act ("RICO"). See 18 U.S.C. §§ 1961-1968. The district court granted Hall's motion for judgment on the pleadings due to the court's determination that section 2(b) of the McCarran-Ferguson Act (15 U.S.C. § 1011, et seq.) precluded the application of RICO to Hall's alleged wrongdoing. We have jurisdiction pursuant to 28 U.S.C. § 1291. We reverse and remand.

I

Merchants' complaint alleges: Merchants is a national company engaged in shipping and delivering packages. It retained Hall on a continuing basis to secure numerous insurance policies and to process claims for which Merchants was self-insured. Merchants says that employees

of Hall, with Hall's knowledge or acquiescence, defrauded Merchants in three ways: (1) by overbilling Merchants for insurance premiums on actual policies, (2) by billing Merchants for premiums on nonexistent policies, and (3) by billing Merchants for direct, uninsured claims that were never paid to the claimants. Merchants alleges that these fraudulent acts were accomplished through use of the mails and wires, thus bringing them within the scope of RICO.

Merchants asserts numerous state law claims in addition to its RICO claims. The district court declined to exercise supplemental jurisdiction over the state law claims, and Merchants is pursuing those claims in state court. Hall moved for judgment on the pleadings (Fed. R. Civ. P. 12(c)), which the district court granted, ultimately disposing of the claims against all defendants in three successive judgments. Merchants timely appealed from each judgment and the appeals were consolidated.

II

We review a judgment on the pleadings *de novo*, *Westlands Water Dist. v. Firebaugh Canal*, 10 F.3d 667, 670 (9th Cir. 1993). Judgment on the pleadings is properly granted when, taking all allegations in the pleadings as true, the moving party is entitled to judgment as a matter of law. *Id.* The district court determined that, irrespective of whether Merchants' complaint states a claim under RICO, judgment in favor of Hall was appropriate because the operation of the McCarran-Ferguson Act makes RICO inapplicable to the facts alleged.

III

Congress enacted the McCarran-Ferguson Act in part to allow the states to regulate the business of insurance free from inadvertent preemption by federal statutes of general

applicability. *See Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 218, 99 S.Ct. 1067, 1076, 59 L. Ed. 2d 261 (1979). Section 2(b) of the Act accomplishes this purpose through a limited "inverse preemption," by directing that a federal law of general applicability does not apply to the "business of insurance" if the federal law conflicts with state laws enacted to regulate that business. *See* 15 U.S.C. § 1012(b).

Section 2(b) provides, in relevant part: "No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance." *Id.* The terms of the statute suggest a four part inquiry for determining when § 2(b) precludes the application of a federal statute. *See Cochran v. Paco, Inc.*, 606 F.2d 460, 464 (5th Cir. 1979). The McCarran-Ferguson Act precludes the application of a federal statute if: (1) the statute does not "specifically relate" to the business of insurance, (2) the acts challenged under the statute constitute the business of insurance, (3) the state has enacted a law or laws regulating the challenged acts, and (4) the state law would be superseded, impaired or invalidated by the application of the federal statute. *Id.* All four factors must be satisfied. The parties agree that this well-settled four factor test governs the present dispute.

The first and third elements are not at issue here. As Merchants concedes, RICO does not specifically relate to the business of insurance. *See* 18 U.S.C. §§ 1961, 1962 (listing activities proscribed by RICO). Also, California has enacted a comprehensive insurance code, which prohibits the acts alleged by Merchants.[1] *See Feinstein v. Nettle-*

[1]Merchants argues that certain of Hall's alleged practices are not regulated by the California Insurance Code *because the practices are not*

ship Co., 714 F.2d 928, 933 (9th Cir. 1983), *cert. denied*, 466 U.S. 972, 104 S. Ct. 2346, 80 L. Ed. 2d 820 (1984); Cal. Ins. Code §§ 790-790.10 (West 1995). Thus, only the second and fourth elements are disputed.

IV

We first address whether the practices alleged by Merchants fall within the business of insurance under § 2(b). We hold that overcharging for premiums on actual insurance policies is the business of insurance, but that collecting premiums on false policies and charging for unpaid, uninsured claims are not.

A

The parties contest the proper scope of inquiry concerning whether the acts challenged under RICO constitute the business of insurance. Merchants argues that the court must look only to the wrongful component of the acts alleged, positing that "fraud and theft cannot be the 'business of insurance.'" It finds support for this position in several district court decisions. *See, e.g., Thacker v. New York Life Ins. Co.*, 796 F. Supp. 1338, 1342 (E.D. Cal. 1992). Hall argues that this approach is much too narrow, and that the entire relationship between the parties must be examined to determine whether the challenged acts occurred in the business of insurance. Hall's position also has support from several district courts. *See, e.g., Wexco, Inc. v. IMC, Inc.*, 820 F. Supp. 194, 199 (M.D. Pa. 1993). The district court adopted Hall's reasoning.

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the business of insurance. This is simply a repetition of Merchants' argument on the second element. The relevant inquiry on the third element is satisfied; to the extent Hall's acts *do* constitute the business of insurance, it is not disputed that the acts are proscribed by the California Insurance Code.

Neither party has identified the proper scope of inquiry. The approach put forth by Hall is too broad. The Supreme Court has stated that the McCarran-Ferguson Act "does not exempt the business of insurance companies .... The exemption is for the 'business of insurance[.]' " *Royal Drug,* 440 U.S. at 210-11, 99 St. Ct. at 1073. Thus, the proper inquiry is whether a particular "practice constitutes the business of insurance," not whether the defendant or the plaintiff transact the business of insurance in general. *See Nettleship,* 714 F. 2d at 931.

Merchants' proposed test, however, defines the challenged practice too narrowly. As the Seventh Circuit stated, "it is not helpful to point to a practice forbidden by federal law ... and observe that this practice is not itself insurance." *NAACP. v. American Family Mut. Ins. Co.*, 978 F.2d 287, 294 (7th Cir. 1992) (Easterbrook, J.) *cert. denied,* ____ U.S. ____, 113, S. Ct. 2335, 124 L. Ed. 2d 247 (1993). This interpretation of the rule would read the McCarran-Ferguson Act out of existence. Any practice which violated any federal statute would, by definition, not be the "business of insurance," resulting in all federal statutes applying to the business of insurance with their "full rigor." *See id.* This is not the result Congress intended. Therefore, we hold that the property inquiry is whether, taken as a whole, the specific practice being challenged under federal law is a part of the "business of insurance."

B

The Supreme Court has identified three factors to be applied in determining whether a practice constitutes the business of insurance: (1) whether the practice has the effect of transferring or spreading the policyholders' risks, (2) whether the practice is an integral part of the policy relationship between the insurer and the insured, and (3) whether the practice is limited to entities within the insur-

ance industry.[2] *See United Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 129, 102 S. Ct. 3002, 3008-09, 73 L. Ed. 2d 647 (1982). The Supreme Court has made it clear that the transfer or spreading of the risk is the primary or even "indispensable" characteristic of the business of insurance. *Id.* at 127, 102 S. Ct. at 3007-08; *Royal Drug*, 440 U.S. at 211-12, 99 S. Ct. at 1073-74. Our own cases applying these factors also "emphasize that the primary characteristic of the business of insurance is the transferring or spreading of risk." *Nettleship*, 714 F.2d at 931.

Merchants alleges three types of fraudulent practices by Hall: (1) overcharging for premiums on actual policies, (2) collecting premiums on fictitious policies, and (3) collecting payments for uninsured claims which Hall did not actual pay. We address each practice separately.

I

Overcharging for premiums on actual policies is part of the business of insurance. All three factors are satisfied. First, Merchants actually was a party to an insurance policy which transferred and spread its risks. The payment and collection of premiums is necessary to the risk-spreading transaction; if the premiums are not paid, the policy will

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[2]Hall argues that this three factor analysis should only be applied in the antitrust area, where the "business of insurance" is meant to be defined narrowly. Hall contends that *United States Department of the Treasury v. Fabe*, ____ U.S. ____, 113 S. Ct. 2202, 124 L. Ed. 2d 449 (1993) supports this position. We disagree. *In Fabe*, the Supreme Court actually applied the three factors above, emphasizing that the acts involved there affected the transfer or spreading of risk. *See id.* at ____, 113 S. Ct. at 2208-09. On the other hand, Hall is correct that the Court held the business of insurance was to be defined more broadly outside the antitrust area. *Id.* at ____-____, 113 S. Ct. at 2209-10. This is a matter of degree, however, rather than a wholesale change in the inquiry.

lapse and the risk spreading relationship will be terminated. Second, an insurance broker's collection of premiums is integral, though not indispensable, to the relationship between the insured and the insurer. Finally, only in the insurance industry are insurance policies written and insurance premiums collected. Merchants' claim here is not that it was never insured or that its risk was not spread, but simply that it was charged more than it should have been for the insurance coverage it received. This type of transaction is at the core of the "business of insurance."

2

We fail to see, however, how the collection of premium payments for nonexistent policies falls within the business of insurance. Where there is no insurance policy, the first two factors are not satisfied: Merchants' risk is not spread, and there is no relationship at all between it and the insurer. This conclusion is supported by the very wording of the first two factors, which assumes the existence of a "policy." *See Nettleship*, 714 F.2d at 931 (explaining that inquiries are whether the "policyholder's" risk is spread, and whether the practice is an integral part of the "policy relationship between insurer and insured"). The third factor is arguably not satisfied either. Because no policy was sold at all, this practice comes close to being the "business of fraud," as characterized by Merchants. Money can be fraudulently collected for a nonexistent product in any field. On the other hand, where the products falsely being offered are insurance policies, public policy concerns specific to the business of insurance may be implicated (e.g. there may be a particularly strong public interest concern against such fraud, as it directly affects the existence and reliability of insurance contracts). Therefore, the third factor does not weigh conclusively in either direction.

Given the Supreme Court's clear statements that the transfer or spreading of risk is the primary factor to be considered, the absence of this element requires, at a minimum, that the other two factors weigh strongly in Hall's favor in order for its practice to fall within the business of insurance. *See SEC v. National Sec., Inc.*, 393 U.S. 453, 460, 89 S.Ct. 564, 568, 21 L.Ed.2d 668 (1969) ("The relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation and enforcement — these were the core of the 'business of insurance.' ") The existence of a contractual policy relationship is therefore of central, if not essential, importance. Hall has not shown that the practice of collecting premiums on sham insurance policies "relate[s] so closely" to the policy relationship as to outweigh the lack of a policy itself. *See, id.*

3

The third challenged practice, collecting money for false claims to be directly paid by Merchants, is not even arguably the business of insurance. This practice satisfies none of the factors. There is no spreading or transfer of the risk. Indeed, even had the transactions not been fraudulent, the parties always contemplated that Merchants would bear its own risk. There is no policy relationship between Merchants and any insurer. Finally, the practice is not limited to the insurance industry. Merchants could pay these claims itself, without using Hall as an intermediary, or could use a different company as its agent for claims adjustment. Hall simply happens to be an insurance broker which Merchants engaged to administer claims settlement. This practice is not the business of insurance.

V

As some of Hall's alleged practices fall within the business of insurance, it is necessary for us to determine whether

the application of RICO to those practices would "invalidate, impair, or supersede" California's laws regulating those practices. We hold the application of RICO to Hall's alleged fraudulent acts is consistent with California's insurance laws.

A

The parties again argue in favor of widely disparate standards for determining whether a federal law invalidates, impairs or supersedes state insurance regulations. Hall argues that the term "impair" is intended to be a very broad proscription against applying federal law where a state has regulated, *or chosen not to regulate*, in the insurance industry. Under this construction of § 2(b), Hall argues that the private right of action for treble damages and mandatory attorney fees allowed by RICO would upset the balance struck by California's insurance code, which, in general, allows only administrative enforcement and actual damages. *See Moradi-Shalal v. Fireman's Fund Ins. Cos.*, 46 Cal. 3d 287, 250 Cal. Rptr. 116, 758 P.2d 58, 68-69 (1988). Again, Hall draws on district court decisions to support its position. *See, e.g., Wexco*, 820 F. Supp. at 204. This argument amounts to the contention that Congress intended the McCarran-Ferguson Act to allow states to preempt the field in the regulation of the business of insurance.

Merchants counters with a much narrower reading of the McCarran-Ferguson Act's "inverse preemption." Under Merchants' construction, application of a federal law would be precluded only where the federal law expressly prohibited acts permitted by state law, or vice versa. Further, Merchants' argues that the California statute's express statement that it is cumulative with *state* common law causes of action weighs against Hall's "delicate balance" argument. Merchants has support from several district

courts for this position as well. *See, e.g., Thacker,* 796 F. Supp. at 1343.

We have not previously addressed the question of exactly when a federal statute "invalidate[s], impair[s], or supersede[s]" a state law under § 2(b). The Seventh Circuit, however, recently addressed this issue in *NAACP v. American Family Mutual Insurance Co.,* 978 F.2d 287 (7th Cir. 1992). In that case, the court was faced with the question of whether the Fair Housing Act could be invoked to prohibit "redlining" by home insurers. As in the present case, state law prohibited the conduct, but allowed only administrative remedies, whereas the federal law allowed a private right of action. *See id.* at 295. In a very thorough opinion, Judge Easterbrook expressly rejected the "upset the balance" argument and concluded that the narrower "direct conflict" construction of the McCarran-Ferguson Act was appropriate. *Id.* at 296-97.

In reaching its conclusion, the Seventh circuit analogized to the principles governing *federal* preemption of *state* law in areas heavily regulated by federal statute. For example, in the area of nuclear power, despite pervasive federal regulation and a lower cap on liability under federal law, the Supreme Court upheld a state punitive damages award for acts prohibited by both state and federal law. *See Silkwood v. Kerr-McGee Corp.,* 464 U.S. 238, 256, 104 S.Ct. 615, 624, 78 L.Ed.2d 443 (1984). The Seventh Circuit went on to catalog many additional Supreme Court cases upholding cumulative state *remedies* for conduct deemed wrongful under both state and federal law. *American Family,* 978 F.2d at 2963[3] Thus, the court concluded that state and federal laws proscribing identical conduct do not con-

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[3] Although *Silkwood's* specific holding was superseded by statute (42 U.S.C. § 2210(s)), the general principle remains viable.

flict with or displace each other, and may coexist under the McCarran-Ferguson Act. *Id.* at 297.

We adopt the Seventh Circuit's well-reasoned approach. The language of § 2(b) is inconsistent with a congressional intent to allow states to preempt the field of insurance regulation. First, § 2(b)'s exemption of federal laws which specifically relate to the business of insurance weighs against a congressional intent wholly to abandon the field to the states. Second, only federal statutes which "invalidate, impair, or supersede" state insurance statutes are "preempted." If Congress had intended to cede the field, it could have said: "No federal statute shall be construed to *apply* to the business of insurance." Instead, it allowed federal statutes to apply unless they conflict with the states' statutes. The terms of the Act's "inverse preemption" are not so broad as Hall would have it.

We hold that the application of a federal statute prohibiting acts which are also prohibited under a state's insurance laws does not "invalidate, impair, or supersede" the state's laws under § 2(b) of the McCarran-Ferguson Act.

B

Under this rule, § 2(b) allows the application of RICO to the present facts. Hall concedes, indeed strenuously argues, that California law prohibits the acts alleged by Merchants. As RICO prohibits these same acts, there is no conflict; RICO does not invalidate, impair, or supersede California law in this context.

VI

We REVERSE the district court's judgments in favor of defendants and REMAND to that court for further proceedings consistent with this opinion.

18 U.S.C. § 1964. Civil Remedies

(a) The district courts of the United States shall have jurisdiction to prevent and restrain violations of section 1962 of this chapter by issuing appropriate orders, including, but not limited to: ordering any person to divest himself of any interest, direct or indirect, in any enterprise; imposing reasonable restrictions on the future activities or investments of any person, including but not limited to, prohibiting any person from engaging in the same type of endeavor as the enterprise engaged in, the activities of which affect interstate or foreign commerce; or ordering dissolution or reorganization of any enterprise, making due provision for the rights of innocent persons.

(b) The Attorney General may institute proceedings under this section. Pending final determination thereof, the court may at any time enter such restraining orders or prohibitions, or take such other actions, including the acceptance of satisfactory performance bonds, as it shall deem proper.

(c) Any person injured in his business or property by reason of a violation of section 1962 of this chapter may sue therefor in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee.

(d) A final judgment or decree rendered in favor of the United States in any criminal proceeding brought by the United States under this chapter shall estop the defendant from denying the essential allegations of the criminal offense in any subsequent civil proceeding brought by the United States.

CALIFORNIA'S UNFAIR INSURANCE PRACTICES ACT

California Insurance Code § 790 Purpose Of Article; Regulation Of Trade Practices In Insurance Business

The purpose of this article is to regulate trade practices in the business of insurance in accordance with the intent of Congress as expressed in the Act of Congress of March 9, 1945 (Public Law 15, Seventy-ninth Congress),[4] by defining, or providing for the determination of, all such practices in this State which constitute unfair methods of competition or unfair or deceptive acts or practices and by prohibiting the trade practices so defined or determined.

§ 790.01. Application Of Article

This article applies to reciprocal and interinsurance exchanges, Lloyds insurers, fraternal benefit societies, fraternal fire insurers, grants and annuities societies, insurers holding certificates of exemptions, motor clubs, non-profit hospital associations, life agents, broker-agents, surplus line brokers and special lines surplus line brokers as well as all other persons engaged in the business of insurance.

§ 790.02. Engaging In Trade Practice Defined As Unfair Method Of Competition Prohibited

No person shall engage in this State in any trade practice which is defined in this article as, or determined pursuant to this article to be, an unfair method of competition or an unfair or deceptive act or practice in the business of insurance.

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[4] 15 U.S.C.A. §§ 1011 *et seq.*

§ 790.03. Prohibited Acts

The following are hereby defined as unfair methods of competition and unfair and deceptive acts or practices in the business of insurance.

(a) *[Misrepresentations: False or Misleading Statements]* Making, issuing, circulating, or causing to be made, issued or circulated, any estimate, illustration, circular or statement misrepresenting the terms of any policy issued or to be issued or the benefits or advantages promised thereby or the dividends or share of the surplus to be received thereon, or making any false or misleading statement as to the dividends or share of surplus previously paid on similar policies, or making any misleading representation or any misrepresentation as to the financial condition of any insurer, or as to the legal reserve system upon which any life insurer operates, or using any name or title of any policy or class of policies misrepresenting the true nature thereof, or making any misrepresentation to any policyholder insured in any company for the purpose of inducing or tending to induce such policyholder to lapse, forfeit, or surrender his or her insurance.

(b) *[Untruthful, Deceptive, or Misleading Statements]* Making or disseminating or causing to be made or disseminated before the public in this state, in any newspaper or other publication, or any advertising device, or by public outcry or proclamation, or in any other manner or means whatsoever, any statement containing any assertion, representation or statement with respect to the business of insurance or with respect to any person in the conduct of his or her insurance business, which is untrue, deceptive, or misleading, and which is known, or which by the exercise of reasonable care should be known, to be untrue, deceptive, or misleading.

(c) *[Unreasonable Restraint of, or Monopoly in, Business of Insurance]* Entering into any agreement to commit, or by any concerted action committing, any act of boycott, coercion or intimidation resulting in or tending to result in unreasonable restraint of, or monopoly in, the business of insurance.

(d) *[False Statements of Insurer's Financial Condition]* Filing with any supervisory or other public official, or making, publishing, disseminating, circulating, or delivering to any person, or placing before the public, or causing directly or indirectly, to be made, published, disseminated, circulated, delivered to any person, or placed before the public any false statement of financial condition of an insurer with intent to deceive.

(e) *[False Entries; Willful Omissions]* Making any false entry in any book, report, or statement of any insurer with intent to deceive any agent or examiner lawfully appointed to examine into its condition or into any of its affairs, or any public official to whom the insurer is required by law to report, or who has authority by law to examine into its condition or into any of its affairs, or, with like intent, willfully omitting to make a true entry of any material fact pertaining to the business of the insurer in any book report, or statement of the insurer.

(f) *[Unfair Rate Discrimination]* Making or permitting any unfair discrimination between individuals of the same class and equal expectation of life in the rates charged for any contract of life insurance or life annuity or in the dividends or other benefits payable thereon, or in any other of the terms and conditions of the contract.

This subdivision shall be interpreted, or any contract of ordinary life insurance or individual life annuity applied for and issued on or after January 1, 1981, to require differentials based upon the sex of the individual insured or annui-

tant in the rates or dividends or benefits, or any combination thereof. This requirement is satisfied if those differentials are substantially supported by valid pertinent data segregated by sex, including, but not necessarily limited to, mortality data segregated by sex.

However, for any contract of ordinary life insurance or individual life annuity applied for and issued on or after January 1, 1981, but before the compliance date, in lieu of those differentials based on data segregated by sex, rates, or dividends or benefits, or any combination thereof, for ordinary life insurance or individual life annuity on a female life may be calculated as follows: (a) according to an age not less than three years nor more than six years younger than the actual age of the female insured or female annuitant, in the case of a contract of ordinary life insurance with a face value greater than five thousand dollars ($5,000) or a contract of individual life annuity; and (b) according to an age not more than six years younger than the actual age of the female insured, in the case of a contract of ordinary life insurance with a face value of five thousand dollars ($5,000) or less. "Compliance date" as used in this paragraph shall mean the date or dates established as the operative date or dates by future amendments to this code directing and authorizing life insurers to use a mortality table containing mortality data segregated by sex for the calculation of adjusted premiums and present values for nonforfeiture benefits and valuation reserves as specified in Section 10163.5 and 10489.2 or successor sections.

Notwithstanding the provisions of this subdivision, sex based differentials in rates or dividends or benefits, or any combination thereof, shall not be required for (1) any contract of life insurance or life annuity issued pursuant to arrangements which may be considered terms, conditions, or privileges of employment as these terms are used in Title VII of the Civil Rights Act of 1964 (Public Law 88-352), as

amended, and (2) tax sheltered annuities for employees of public schools or of tax exempt organizations described in Section 501(c)(3) of the Internal Revenue Code.

(g) *[Statement of Membership in California Insurance Association]* Making or disseminating, or causing to be made or disseminated, before the public in this state, in any newspaper or other publication, or any other advertising device, or by public outcry or proclamation, or in any other manner or means whatever, whether directly or by implication, any statement that a named insurer, or named insurers, are members of the California Insurance Guarantee Association, or insured against insolvency as defined in Section 119.5. This subdivision shall not be interpreted to prohibit any activity of the California Insurance Guarantee Association or the commissioner authorized, directly or by implication, by Article 14.2 (commencing with Section 1063).

(h) *[Unfair Claims Settlement Practices]* Knowingly committing or performing with such frequency as to indicate a general business practice any of the following unfair claims settlement practices:

(1) Misrepresenting to claimants pertinent facts or insurance policy provisions relating to any coverages at issue.

(2) Failing to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies.

(3) Failing to adopt and implement reasonable standards for the prompt investigation and processing of claims arising under insurance policies.

(4) Failing to affirm or deny coverage of claims within a reasonable time after proof of loss requirements have been completed and submitted by the insured.

(5) Not attempting in good faith to effectuate prompt, fair, and equitable settlements of claims in which liability has become reasonably clear.

(6) Compelling insureds to institute litigation to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in actions brought by the insureds, when the insureds have made claims for amounts reasonably similar to the amounts ultimately recovered.

(7) Attempting to settle a claim by an insured for less than the amount to which a reasonable man would have believed he was entitled by reference to written or printed advertising material accompanying or made part of an application.

(8) Attempting to settle claims on the basis of an application which was altered without notice to, or knowledge or consent of, the insured, his or her representative, agent, or broker.

(9) Failing, after payment of a claim, to inform insureds or beneficiaries, upon request by them, of the coverage under which payment has been made.

(10) Making known to insureds or claimants a practice of the insurer of appealing from arbitration awards in favor of insureds or claimants for the purpose of compelling them to accept settlements or compromises less than the amount awarded in arbitration.

(11) Delaying the investigation or payment of claims by requiring an insured, claimant, or the physician of either, to submit a preliminary claim report, and then requiring the subsequent submission of formal proof of loss forms, both of which submissions contain substantially the same information.

(12) Failing to settle claims promptly, where liability has become apparent, under one portion of the insurance policy coverage in order to influence settlements under other portions of the insurance policy coverage.

(13) Failing to provide promptly a reasonable explanation of the basis relied on in the insurance policy, in relation to the facts or applicable law, for the denial of a claim or for the offer of a compromise settlement.

(14) Directly advising a claimant not to obtain the services of an attorney.

(15) Misleading a claimant as to the applicable statute of limitations.

(16) Delaying the payment or provision of hospital, medical, or surgical benefits for services provided with respect to acquired immune deficiency syndrome or AIDS-related complex for more than 60 days after the insurer has received a claim for those benefits, where the delay in claim payment is for the purpose of investigating whether the condition preexisted the coverage. However, this 60-day period shall not include any time during which the insurer is awaiting a response for relevant medical information from a health care provider.

§ 790.034. Regulations; Settlement of Claims

Regulations adopted by the commissioner pursuant to this article which relate to the settlement of claims shall take into consideration settlement practices by classes of insurers.

§ 790.035. Unfair Competition and Unfair or Deceptive Acts or Practices; Civil Penalty

(a) Any person who engages in any unfair method of competition or any unfair or deceptive act or practice defined in Section 790.03 is liable to the state for a civil penalty to be fixed by the commissioner, not to exceed five

thousand dollars ($5,000) for each act, or, if the act or practice was willful, a civil penalty not to exceed ten thousand dollars ($10,000) for each act. The commissioner shall have the discretion to establish what constitutes an act. However, when the issuance, amendment, or servicing of a policy or endorsement is inadvertent, all of those acts shall be a single act for the purpose of this section.

(b) The penalty imposed by this section shall be imposed by and determined by the commissioner as provided by Section 790.05. The penalty imposed by this section is appealable by means of any remedy provided by Section 12940 or by Chapter 5 (commencing with Section 11500) of Part 1 of Division 3 of Title 2 of the Government Code.

§ 790.036. Advertising of Insurance that will not be Sold

(a) It is an unfair and deceptive act or practice in the business of insurance for an insurer to advertise insurance that it will not sell.

(b) Nothing in this section shall be construed to prohibit any insurer from advertising insurance products for which it is licensed to sell in this state where the product is not available for sale so long as the unavailability is disclosed in the advertisement.

(c) A violation of this section is subject to the sanctions provided for by this article.

(d) An intentional violation of this section is a misdemeanor punishable by a fine not exceeding ten thousand dollars ($10,000).

(e) This section does not apply to any insurer that refuses to sell a policy of insurance on the basis of its underwriting guidelines.

(f) This section does not apply to advertisements by an insurer where the advertisements are broadcast and origi-

nate from outside this state. As used in this subdivision, "broadcast" includes electronic media, television, and radio. As used in this subdivision, "originate from outside this state" includes cable transmittal of programs broadcast by stations located outside California.

§ 790.04. Powers of Commissioner; Examinations and Investigations

The commissioner shall have power to examine and investigate into the affairs of every person engaged in the business of insurance in the State in order to determine whether such person has been or is engaged in any unfair method of competition or in any unfair or deceptive act or practice prohibited by Section 790.03 or determined pursuant to this article to be an unfair method of competition or an unfair or deceptive practice in the business of insurance. Such investigation may be conducted pursuant to Article 2 (commending at Section 11180) of Chapter 2, Part 1, Division 3, Title 2 of the Government Code.

§ 790.05. Order to Show Cause; Hearing; Cease and Desist Order; Review

Whenever the commissioner shall have reason to believe that such person has been engaged or is engaging in this state in any unfair method of competition or any unfair or deceptive act or practice defined in Section 790.03, and that a proceeding by the commissioner in respect thereto would be to the interest of the public, he or she shall issue and serve upon that person an order to show cause containing a statement of the charges in that respect, a statement of that person's potential liability under Section 790.035, and a notice of a hearing thereon to be held at a time and place fixed therein, which shall not be less than 30 days after the service thereof, for the purpose of determining whether the commissioner should issue an order to that person to, pay

the penalty imposed by Section 790.035, and to cease and desist those methods, acts, or practices or any of them.

If the charges or any of them are found to be justified the commissioner shall issue and cause to be served upon that person an order requiring that person to pay the penalty imposed by Section 790.035 and to cease and desist from engaging in those methods, acts, or practices found to be unfair or deceptive.

The hearing shall be conducted in accordance with the Administrative Procedure Act, Chapter 5 (commencing at Section 11500) of Part 1 of Division 3 of Title 2 of the Government Code, and the commissioner shall have all the powers granted therein.

The person shall be entitled to have the proceedings and the order reviewed by means of any remedy provided by Section 12940 of this code or by the Administrative Procedure Act.

§ 790.06. Engaging in Practices Not Defined in Section 790.03

(a) Whenever the commissioner shall have reason to believe that any person engaged in the business of insurance is engaging in this State in any method of competition or in any act or practice in the conduct of such business which is not defined in Section 790.03 and that such method is unfair or that such act or practice is unfair or deceptive and that a proceeding by him in respect thereto would be in the interest of the public, he may issue and serve upon such person an order to show cause containing a statement of the methods, acts or practices alleged to be unfair or deceptive and a notice of hearing thereon to be held at a time and place fixed therein, which shall not be less than 30 days after the service thereof, for the purpose of determining whether the alleged methods, acts or practices or any of them should be declared to be unfair or deceptive within the meaning of this article.

The hearings provided by this section shall be conducted in accordance with the Administrative Procedure Act, Chapter 5 (commencing at Section 11500) of Part 1, Division 3, Title 2 of the Government Code, and the commissioner shall have all the powers granted therein. If the alleged methods, acts, or practices or any of them are found to be unfair or deceptive within the meaning of this article the commissioner shall issue and service upon said person his written report so declaring.

(b) If such report charges a violation of this article and if such method of competition, act or practice has not been discontinued, the commissioner may, through the Attorney General of this State, at any time after 30 days after the service of such report cause a petition to be filed in the superior court of this State within the county wherein the person resides or has his principal place of business, to enjoin and restrain such person from engaging in such method, act or practice. The court shall have jurisdiction of the proceeding and shall have the power to make and enter appropriate orders in connection wherewith and to issue such writs are ancillary to its jurisdiction or are necessary in its judgment to prevent injury to the public pendente lite.

(c) A transcript of the proceedings before the commissioner, including all evidence taken and the report and findings shall be filed with such petition. If either party shall apply to the court for leave to adduce additional evidence and shall show, to the satisfaction of the court, that such additional evidence is material and there were reasonable grounds for the failure to adduce such evidence in the proceeding before the commissioner, the court may order such additional evidence to be taken before the commissioner and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The commissioner may modify his findings of fact or make new findings by reason of the additional

evidence so taken, and he shall file such modified or new findings with the return of such evidence.

(d) If the court finds that the method of competition complained of is unfair or that the act or practice complained of is unfair or deceptive, that the proceeding by the commissioner with respect of the public and that the findings of the commissioner are supported by the weight of the evidence, it shall issue its order enjoining and restraining the continuance of such method of competition, act or practice.

§ 790.07. Violation of Cease and Desist Order; Hearing; Penalty; Review

Whenever the commissioner shall have reason to believe that any person has violated a cease and desist order issued pursuant to Section 790.05 or a court order issued pursuant to Section 790.06, after the order has become final, and while the order is still in effect, the commissioner may, after a hearing at which it is determined that the violation was committed, order that person to forfeit and pay to the State of California a sum not to exceed five thousand dollars ($5,000) plus any penalty due under Section 790.05, which may be recovered in a civil action, except that, if the violation is found to be willful, the amount of the penalty may be a sum not to exceed fifty-five thousand dollars ($55,000) plus the penalty due under Section 790.05.

For the purposes of this section, the failure to pay any penalty imposed pursuant to Section 790.035 which has become final shall constitute a violation of the cease and desist order.

For any subsequent violation of the cease and desist order or of the court order or the order to pay the penalty, while the order is still in effect, the commissioner may, after hearing, suspend or revoke the license or certificate of that person for a period not exceeding one year; provided, however, no such proceeding shall be based upon the subsequent

violation unless the same was committed or continued after the date on which the order imposing the penalty pursuant to the preceding paragraph became final.

The hearings provided by this section shall be conducted in accordance with the Administrative Procedure Act, and the commissioner shall have all the powers granted therein. The person shall be entitled to have the proceedings and the order of the commissioner therein reviewed by means of any remedy provided by Section 12940 or by the Administrative Procedure Act.

§ 790.08. Additional Powers of Commissioner

The powers vested in the commissioner in this article shall be additional to any other powers to enforce any penalties, fines or forfeitures, denials, suspensions or revocations of licenses or certificates authorized by law with respect to the methods, acts and practices hereby declared to be unfair or deceptive.

§ 790.09. Administrative Action Against License or Certificate; Civil Liability; Criminal Penalty

No order to cease and desist issued under this article directed to any person or subsequent administrative or judicial proceeding to enforce the same shall in any way relieve or absolve such person from any administrative action against the license or certificate of such person, civil liability or criminal penalty under the laws of this State arising out of the methods, acts or practices found unfair or deceptive.

§ 790.10. Rules and Regulations

The commissioner shall, from time to time as conditions warrant, after notice and public hearing, promulgate reasonable rules and regulations, and amendments and additions thereto, as are necessary to administer this article.